

Internal Revenue Service

**memorandum**

TL-N-6724

WHEARD CC:TL:TS

date: **SEP 1 1988**

to: District Counsel, Laguna Nigel W:LN

from: Director, Tax Litigation Division CC:TL:TS

subject:

**Claim for Attorney Fees**

This is in response to your request for technical advice dated May 26, 1988.

ISSUES

1. Whether petitioner is entitled to reasonable attorneys' fees under the facts of this case?
2. What amount of attorneys' fees are reasonable?

CONCLUSION

1. Under the reenactment of I.R.C. § 7430, petitioner may be entitled to attorneys' fees caused by administrative inaction following the initial contact by the appeal's office to District Counsel attorney Bill Sabin. Furthermore, there is a substantial hazard that the Ninth Circuit would also require attorneys' fees to be awarded for administrative action or inaction prior to involvement by District Counsel. Finally, we would prefer a case with better facts for the first case likely to be appealed to the Ninth Circuit under the 1986 amendment to section 7430. Thus, this case should be settled.

2. Reasonable attorney fees are defined in section 7430(c) as fees not in excess of \$75 per hour subject to the discretion of the court to increase the fees. Thus, the proposed settlement properly reduces attorney fees to this hourly amount.

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FACTS

A Notice of Deficiency for the taxable years [REDACTED] and [REDACTED] was mailed to the petitioner on the [REDACTED] day of [REDACTED].

The statutory notice set forth deficiencies as a result of adjustments for investments in [REDACTED] and [REDACTED]. The losses and expenses were reported as partnership flow through items on Schedule E.

The petitioner immediately retained the services of [REDACTED] in order to file a petition with the Tax Court. [REDACTED] researched the petition and the facts of the case and learned that the notice included only TEFRA items.

According to the Administrative files, [REDACTED] contacted the Appeals Officer on [REDACTED] to discuss the case. On [REDACTED] he wrote to Mr. Rovnak, the assigned Appeals Officer, to request rescission of the statutory notice. [REDACTED] recited all TEFRA information relating to both partnerships, the docket number under which one partnership petition was filed and the name and telephone number of the revenue agent conducting the other partnership's audit. On [REDACTED] [REDACTED] again called for Mr. Rovnak and requested a return call. The file does not indicate that calls were returned or that the [REDACTED] letter was answered.

Mr. Rovnak consulted with Bill Sabin, an attorney from District Counsel's office between [REDACTED] and [REDACTED]. Mr. Rovnak's notes indicate that Mr. Sabin advised him that the statutory notice was incorrectly sent because all issues were TEFRA issues. Mr. Sabin orally concurred.

On [REDACTED], [REDACTED] left a telephone message for Mr. Rovnak, indicating that he would file a petition since the statutory notice had not been rescinded. The petition was mailed to the Court on [REDACTED].

[REDACTED] indicated to District Counsel attorney Joseph Mudd on [REDACTED], that Michael Rovnak had agreed to rescind the statutory notice but had not done so before the time for filing of the petition expired. Mr. Rovnak agrees with that statement. He was unable to complete rescission before the deadline for petitioning the statutory notice.

Upon being assigned the petition for answer, Mr. Mudd immediately moved to dismiss for lack of jurisdiction. The petitioner's attorney refused to join in the motion and indicated that he intended to pursue attorneys fees.

A bill for fees was submitted for [REDACTED] hours at rates ranging from \$[REDACTED] to \$[REDACTED] per hour. The bill began with review of the statutory notice. With costs, the entire bill was submitted for \$[REDACTED]. The petitioner's attorney has agreed to accept \$[REDACTED] per hour for billed time, for a reduction to \$[REDACTED].

#### DISCUSSION

I.R.C. § 7430(a) provides as relevant here:

the prevailing party may be awarded a judgment (payable in the case of the Tax Court in the same manner as such award by a district court) for reasonable litigation costs incurred in such proceeding. (emphasis supplied)

Subsection (c)(2) defines "prevailing party" as

any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which -

(i) establishes that the position of the United States in the civil proceeding was not substantially justified . . . (emphasis supplied)

Subsection (c)(4) defines "position of the United States" as including

(A) the position taken by the United States in the civil proceeding, and  
(B) any administrative action or inaction by District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which the proceeding is based.

Section (c)(4) was added in the 1986 Tax Act and is effective for amounts paid after September 30, 1986, in civil actions or proceedings commenced after December 31, 1985. Sec. 1551, Pub. L. 99-514, 100 Stat. 2752.

The "position taken by the United States in the civil proceeding" within the meaning of section 7430(c)(4)(A) applies only to respondent's position after a civil proceeding has been commenced. Weiss v. Commissioner, 89 T.C. 779 (1987), rev'd, Civ. No 88-4017 (Second Circuit June 27, 1988) (rehearing en banc requested) (See discussion infra).

Furthermore, District Counsel's failure to review a statutory notice for legal sufficiency prior to its issuance is not "an . . . inaction by the District Counsel" that gives rise to the "position of the United States" expressed in a notice of deficiency under section 7430(c)(4)(B). Id.; see also Sher v. Commissioner, 89 T.C. 79, 86 (1987), appeal pending, (5th Cir. No. 88-4123) ("Under the statute, our application of the substantially justified standard to administrative actions or inactions prior to the institution of a proceeding is limited to the period beginning with the point at which District Counsel has become involved").

District Counsel attorney Joseff Mudd's first action in this case upon receipt of the petition was to seek dismissal for lack of jurisdiction. This "position" of the United States, that the case should immediately be dismissed for lack of jurisdiction, "was substantially justified". See Weiss, supra at 784. Compare the actions of District Counsel in Stieha v. Commissioner, 89 T.C. 784 (1987) where counsel objected to petitioner's motion to dismiss for lack of jurisdiction where there was dispositive authority favoring petitioner (which respondent later admitted in withdrawing its objection the day before hearing). Thus, under the above holdings of the Tax Court, petitioner would not be not entitled to attorney's fees in the case at bar for District Counsel's post petition activity.

Furthermore, the pre-petition activity of District Counsel attorney Bill Sabin, limited solely to advising the appeals officer of the invalidity of notice of deficiency, was also substantially justified. Since his involvement was limited to this advice over the phone, presumably, he was not guilty of administrative inaction giving rise to a position of the United States. However, section 7430(c)(4)(B) includes in the definition of "position of the United States":

any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which such proceeding is based.

This phrase is not entirely clear as to whether subsequent administrative action or inaction is limited to that of District Counsel. Arguably, in the present case, however, the inaction of the appeal's officer following District Counsel involvement would constitute "administrative . . . inaction . . . upon which such proceeding [was] based" under the above provision.

Furthermore, District Counsel Attorney Joseph Mudd notes that the Ninth Circuit may not follow the Tax Court's interpretation that attorney fees are not available prior to District Counsel involvement. Unlike several other circuits, the Ninth Circuit has interpreted "position of the United States in the civil proceeding" contained in section 7430, prior to the 1986 amendment, to include pre-petition activity of "the Commissioner" including actions of revenue agents and appeals officers. Sliwa v. Commissioner, 839 F.2d 602, 607 (9th Cir. 1988).<sup>1/</sup> Furthermore, the Court in Sliwa made the following dicta statement with respect to the 1986 amendment of section 7430 (although that amendment was not at issue in the case before it):

Our holding accords with the recent Congressional activity surrounding the re-enactment of section 7430. The Tax Reform Act of 1986 amends section 7430(c) to provide that, for civil tax actions commenced after December 31, 1985, the term "position of the United States" includes both the position taken by the United States in the civil proceeding, and "any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action and inaction) upon which such proceeding is based." 26 U.S.C. § 7430(c)(4)(B) (1987). Although they are not controlling in this case (because Sliwa's tax proceeding was commenced before December 31, 1985) we view these amendments as shedding light on Congress' mandate that § 7430 provide attorneys' fees to a prevailing party in cases where litigation is necessitated by the Government's unreasonable conduct at the administrative level. Id. at 607.

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<sup>1/</sup> In Sliwa petitioner raised facts which arguably should have prevented a notice of deficiency from ever being issued. She did not sufficiently document her innocent spouse status until after she filed a petition, however. District Counsel immediately sought dismissal after this issue was resolved by the appeals office. The Court in Sliwa held that in these circumstances "the position of the United States" was substantially justified based on conduct at the audit, appeals, and litigation stage.

In interpreting the old version of section 7430 the Court in Sliwa interpreted "position of the United States in the civil proceeding", which phrase is retained in the new act, as including pre-petition non District Counsel actions. The 1986 addition of subsection (c)(4)(B) which specifically includes as a "position of the United States" "administrative action or inaction by the District Counsel" supports the Sliwa holding that pre-litigation activity should be examined, but only with respect to the administrative action or inaction following District Counsel involvement. Since the examination of administrative action or inaction under this provision is limited to the actions after involvement by District Counsel, the statute should preclude examination of non District Counsel actions or inactions prior to involvement by District Counsel by negative inference. See Sher v. Commissioner, supra at 86.2/

Furthermore, it is clear that Congress considered and rejected a broader inquiry into the Government's actions or inactions at the administrative level before litigation. The amendment proposed by the Senate provided that the substantially justified standard was applicable to pre-litigation actions or inactions of "Government agents" as well as the litigation position of the Government. The Conference agreement, however, provides that attorney's fees may be awarded with respect to the administrative action or inaction "by the District Counsel of the IRS" (and all subsequent administrative action or inaction) upon which the proceeding is based. H. Rept. 99-841 (Conf.), Vol. II, at II-802 (1986). Sher, supra at 86.

If the Tax Court and Ninth Circuit should limit their examination to post District Counsel activity, the petitioner would arguably be entitled to attorney fees generated after the Appeal's Officer's phone call to the District Counsel

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2/ In Sher, the case was appealable to the Fifth Circuit which had interpreted section 7430 prior to the 1986 amendment in the same way as the Ninth Circuit in Sliwa. The Tax Court held that the earlier interpretation of "position of the United States" in the Fifth Circuit was no longer applicable in light of the 1986 amendment. The Court in Sher held that "[u]nder the statute, our application of the substantially justified standard to administrative actions or inactions prior to the institution of the proceedings is limited to the period beginning with the point at which District Counsel has become involved." This case is currently on appeal to the Fifth Circuit.

attorney. 3/ It is far from certain, however, that the Ninth Circuit will limit its inquiry to post Counsel involvement given their dicta statement in Sliwa and the recent reversal of Weiss in the Second Circuit (rehearing en banc requested).

The Second Circuit reversed Weiss, stating that Congress "with some exceptions, intended to incorporate the standards applicable to the Equal Access to Justice Act (EAJA)." Under that act the issue of whether the Government's position in a litigated matter is substantially justified is determined by examining both in court litigation conduct and any "action or failure to act taken by the agency upon which the civil action is based." 28 U.S.C. § 2412(d)(2)(D). The Court further stated as follows:

We see nothing in the language of the amended version of § 7430 or in its legislative history to suggest that Congress intended to narrow the pre-1986 amendments (sic) view of § 7430 or to limit strictly an examination of the government's position solely to that taken in court. Slip Op. at 12.

Thus, the Court completely read out of the current statute the 1986 clarifying amendment and ignored the narrowing of the scope of the Senate version (which would have included pre-litigation actions of "Government agents") by the Conference Committee.

Given the dicta statement in Sliwa and the appellate opinion in Weiss, there is a substantial hazard that the Ninth Circuit will reverse any holding for respondent in the case at bar. Furthermore, even the Tax Court may hold the Service liable for fees generated by the inaction of the Appeal's Officer after the phone call to the District Counsel attorney. Finally, the facts are worse for respondent in the case at bar than in Sher and

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3/ In Weiss the Tax Court noted that District Counsel's involvement does not typically involve addressing individual case procedures or the details of whether a notice of deficiency should be issued. The Tax Court in Weiss, thus, concluded that the absence of a review of the notice of deficiency prior to issuance did not constitute administrative inaction by district counsel that led to the issuance of the legally insufficient notice of deficiency. Id. at 784.

Weiss since petitioner's counsel did everything he should have done, District Counsel was involved prior to the issuance of the notice of deficiency, and the Service had the opportunity to withdraw the notice of deficiency prior to the petition in this case.

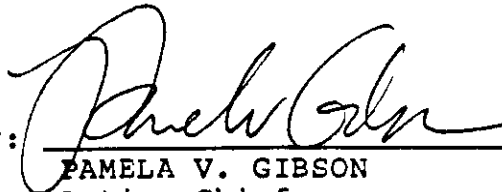
Although we may eventually seek an appellate opinion in the Ninth Circuit, this possibility should be evaluated after the final appellate decisions in the Second and Fifth Circuits. Further, the first appeal in the Ninth Circuit should be for a case in which the facts are more favorable to the Government.

In these circumstances the present case should be settled. We note that you have properly reduced the hourly rate charged by petitioner's counsel to the maximum rate required by section 7430(c)(1)(A)(ii)(III). See Pierce v. Underwood, 487 U.S. \_\_\_\_ (June 27, 1988) (holding increase of fees in excess of \$75.00 based on "special factors" improper).

Please refer any questions you may have to Bill Heard at FTS 566-3289.

MARLENE GROSS

By:

A handwritten signature in dark ink, appearing to read 'Pamela V. Gibson', written over a horizontal line.

PAMELA V. GIBSON  
Acting Chief  
Tax Shelter Branch